No. 96-1923 (5)

In The

Supreme Court of the United States

October Term, 1997

EDWARD S. COHEN,

Petitioner,

vs.

HILDA DE LA CRUZ; NELFO C. JIMENEZ; MARIA MORALES; GLORIA SANDOVAL; HECTOR SANTIAGO; SANTIA SANTOS; ELBA SARAVIA; ELVIA SIGUENZIA; ENILDA TIRADO,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR RESPONDENTS

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QUESTION PRESENTED FOR REVIEW

Whether Congress intended, by enacting the 1984 Amendments to the Bankruptcy Code, to eliminate liability for statutory treble damages awarded on account of the debtor's fraudulent conduct.

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Based on the finding that petitioner committed actual fraud, the United States Court of Appeals for the Third Circuit affirmed a judgment for treble damages against him, and held the entire amount exempt from discharge in bankruptcy under 11 U.S.C. § 523(a)(2)(A). Because this determination clearly comports with Congressional intent and this Court's rulings with respect to fraudulent debtors, the judgment should be affirmed.

STATEMENT OF THE CASE

Respondents were tenants in an eighteen unit apartment building in Hoboken, New Jersey owned by petitioner and his father. (App. 56a).[1] For a number of years, petitioner charged the tenants rents far in excess of that allowed by the City's Rent Leveling Ordinance. (App. 57a-60a). Eventually the tenants, who possessed extremely limited educations and spoke little English, discovered this fact and complained to the local Rent Leveling Administrator. *Id.* After giving petitioner an opportunity to respond, the Administrator issued a determination that petitioner had overcharged respondents a total of $31,382.50. (App. 39a). He was directed to refund this money to the tenants.

Petitioner neither disputed the Administrator's decision nor complied with it. (App. 62a). Indeed, throughout the history of this litigation, petitioner has never disputed the fact that he violated the ordinance nor questioned the amount of the refunds ordered by the Administrator. Instead, he and his father each filed petitions for bankruptcy in the United States Bankruptcy Court for the District of New Jersey. *Id.* Proceeding under Chapter Seven of the Bankruptcy Code, they listed the tenants as unsecured creditors and sought a discharge of the debts owed to them.

1. The Court has dispensed with the printing of a joint appendix. References are to the appendix to the Petition for Certiorari.

On February 14, 1991, the respondents filed a complaint in the Bankruptcy Court contesting the discharge based on 11 U.S.C. § 523(a)(2)(A).[2] *Id.* The complaint further sought the imposition of treble damages pursuant to the New Jersey Consumer Fraud Act. N.J. Stat. Ann. 56:8-1 *et seq.* (App. 38a).

After a bench trial, the Bankruptcy Court rejected petitioner's testimony that he innocently misunderstood the applicable provisions of Hoboken's Rent Leveling Ordinance. (App. 55a). Among other factors, the Court pointed out petitioner's numerous real estate holdings (App. 56a) and his inconsistency in seeking and obtaining rental surcharges allowed by the Ordinance while denying knowledge of those provisions of the law adverse to him. (App. 61a). Finding that the tenants established each of the elements of actual fraud, the Court determined the debts to be non-dischargeable under 11 U.S.C. § 523(a)(2)(A). (App. 71a).

In a subsequent opinion, the Bankruptcy Court determined that petitioner's fraud also constituted a violation of the New Jersey Consumer Fraud Act. Applying the mandatory provisions of the Act, the court entered a non-dischargeable judgment in an amount equal to three times the admitted overcharge. (App. 54a).

Petitioner appealed first to the District Court and then to the United States Court of Appeals. Both courts affirmed the judgment below in its entirety. (App. 2a, 19a). Indeed, even the dissenting judge noted that "petitioner's situation is not one that can generate much sympathy." (App. 18a). All of the Judges agreed that petitioner's conduct constituted actual fraud within

2. It appears that petitioner's father, Nathan Cohen, played only a passive role in the management of the building. Accordingly, respondents did not object to the discharge of the debts owed to them by Nathan Cohen.

the meaning of both the Bankruptcy Code and the state statute and both Courts held that the provisions of 11 U.S.C. § 523(a)(2)(A) rendered the entire judgment non-dischargeable.[3]

Before this Court, petitioner does not question the lower courts' findings that he committed fraud. Rather, he seeks the reversal of that portion of the judgment holding that the treble damages are equally exempted from discharge. On September 29, 1997, the Supreme Court granted certiorari to consider this issue. __ U.S. __, 118 S. Ct. 30 (1997).

SUMMARY OF RESPONDENTS' ARGUMENT

In 1984, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act. Among other provisions, the Act provided for an amendment to 11 U.S.C. § 523 which exempts certain categories of debts from discharge under Chapter 7 of the Bankruptcy Code. 11 U.S.C. § 523(a)(2)(A) now reads as follows:

Exceptions to discharge

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> * * *

3. Respondents have questioned throughout this litigation whether the treble damages awarded here are purely punitive. The Court of Appeals, noting a contrary suggestion by the Supreme Court of New Jersey, nevertheless assumed without deciding that the treble damages served no compensatory purpose. For purposes of clarity, respondents will refer to the treble damages as punitive damages, without conceding this point. (*See* Respondents' Brief in Opposition to Petition, at p. 2).

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

While the precise language of the amendment is ambiguous, an examination of its provisions in the context of the Bankruptcy Code as a whole leaves no doubt that the intent of Congress was to distinguish between legally and fraudulently refinanced credit. This Court has repeatedly held that provisions of the Bankruptcy Code are to be examined in light of its overall purpose, particularly the equitable principle that relief is limited to the "honest but unfortunate debtor".[4] Petitioner's argument, if accepted, would run afoul of this principle and ascribe to Congress an intent to relieve debtors found guilty of fraud from the full consequences of their conduct. Moreover, it would result in Federal interference, through the Bankruptcy Courts, with a state's policy to impose treble damages on perpetrators of fraud.

Petitioner has presented nothing by way of legislative history to support his contention that the 1984 Act was intended to exempt punitive damages from discharge. Decisions by the lower courts as well as dicta in this Court's opinion in *Brown v. Felsen*, 442 U.S. 127 (1979) indicate that prior to 1984 punitive damages awarded for fraud were exempt from discharge. Neither the language of the amended statute nor contemporaneous legislative materials demonstrate any intention to alter this practice.

4. *See Grogan v. Garner*, 498 U.S. 279 (1991); *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552 (1990).

Finally, policy considerations support the judgment below. The imposition of treble damages by statute has become a method by which states seek to deter fraud. Allowing the Bankruptcy Code to act as a shield against the imposition of such damages defeats a state's legitimate decision to impose them. A debtor, no matter how fraudulent his conduct, would be secure in the knowledge that, at worst, he would have to return only the money he received from the defrauded creditor.

For these reasons, the judgment below should be affirmed.

ARGUMENT

11 U.S.C. § 523(a)(2)(A) EXEMPTS FROM DISCHARGE LIABILITIES INCURRED AS A RESULT OF THE DEBTOR'S FRAUD.

In *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.* 458 U.S. 50 (1982), this Court invalidated much of the restructuring of the Bankruptcy Court system established by the Bankruptcy Reform Act of 1978. Pub. L. 95-598, 92 Stat. 2549.[5] Concerned about the chaos that might ensue if the Code was simply declared unconstitutional, the Court stayed its judgment to "afford Congress an opportunity to reconstitute the bankruptcy courts . . ." *Northern*, 458 U.S. at 88. Acting under time constraints, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984.[6] Pub. L. 98-353, 98 Stat. 333.

Although the primary purpose of the 1984 Act was to comply with this Court's ruling in *Northern Pipeline*, the Act

5. Courts generally refer to the pre-1978 law as the "Bankruptcy Act" and the 1978 law as the "Bankruptcy Code". Respondents will utilize these designations.

6. Hereinafter "the 1984 Act".

made a number of changes to the Bankruptcy Code. Many of these changes, including the revision to Section 523(a)(2)(A) at issue here, were grouped into Subtitle H of the Act which was entitled "Miscellaneous Amendments to Title 11." As demonstrated in Point C, *infra*, these amendments received little, if any, attention from Congress.

The parties agree that this case is one of statutory interpretation, and that "statutory interpretation begins with the language of the statute itself". *Pennsylvania Dep't. of Pub. Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990). However, petitioner seeks to limit this Court's inquiry to a highly literal interpretation of the particular phrase at issue here. In this respect, he runs afoul of this Court's admonition that the text of a statute is only the starting point. A proper inquiry into the meaning of a statute requires that "we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Kelly v. Robinson*, 479 U.S. 36,43 (1986) (quoting Justice O'Connor's opinion in *Offshore Logistics, Inc. v. Tallentire*, 477 U.S. 207, 222 (1986)).

As respondents will demonstrate, a proper interpretation of Section 523(a)(2)(A), when considered in light of both the legislative purpose of the Act and this Court's interpretation of the Bankruptcy Code, compels the conclusion that the entire debt incurred as the result of fraud is exempt from discharge.

A. The Expansive Definition Given To The Term "Debt" Covers All Liabilities Incurred As The Result Of The Debtor's Fraud.

Section 523(a) of the Code exempts from discharge certain categories of "debts". Thus, to establish non-dischargeability, a creditor must first prove that the money owed to him is a "debt" within the contemplation of this section. The entire judgment entered against petitioner clearly is such a debt.

The principal lower court decision holding punitive damages dischargeable under Section 523(a)(2)(A) is *In re Levy*, 951 F.2d 196 (9th Cir. 1991). (App. 9a). *Levy*'s assumption that the words "to the extent obtained by" modify the word "debt" is unwarranted given the expansive reading of the term "debt" by Congress and by this Court's decision in *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552 (1990). There, the Court considered whether criminal restitution orders were "debts" under the Code. Noting that Section 101(11) of the Code defines "debt" as a "liability on a claim", the Court first held that the meaning of a "debt" and a "claim" are co-extensive. 495 U.S. at 558. Since Section 101(4)(A) defines a "claim" as a "right to payment . . .", this Court had no difficulty concluding that Congress gave the "broadest possible" meaning to "the class of obligations that qualify as a 'claim' giving rise to a 'debt' ". 495 U.S. at 558.

Respondents' claim for treble damages is clearly a "debt". Petitioner overcharged his tenants and was directed to refund the rents. Since New Jersey's Consumer Fraud Act applies and makes petitioner liable[7] for repayment of three times the amount collected, respondents clearly have a "right to payment" of the entire amount of the judgment. Thus, the treble damage award represents a "debt".

The holding of *In re Levy*, that the phrase "to the extent obtained by . . . fraud" modifies "debt" represents a strained construction of the statute. 951 F.2d at 198. As even the dissent below acknowledged "it would be awkward to think that a debtor

7. This liability was determined by the courts below and is not challenged before this Court.

'obtained' a 'debt', for what the debtor obtains is something of value, thus creating a debt." *In re Cohen,* 106 F.3d at 59. (Greenberg, dissenting). (App. 14a).

Recognizing this weakness in the *Levy* analysis, petitioner argues that "to the extent obtained by . . . fraud" actually modifies "money". Therefore, he contends, his debt to the respondents is exempted from discharge only to the extent that it represents "money . . . obtained by . . . fraud". (Brief for Petitioner, p. 12-13). This "clear language", he argues, does not encompass punitive damages since those damages do not represent money he "obtained".

Contrary to petitioner's argument, it is implausible that Congress intended this particular sentence structure. Such a construction would drastically alter past Bankruptcy practice and exonerate debtors from the full consequences of their fraud.

When analyzing the "plain meaning" of this Act, one should keep in mind Justice Frankfurter's remark that "[t]he notion that because the words of a statute are plain its meaning is also plain, is merely pernicious oversimplification." *United States v. Monia,* 317 U.S. 424, 431 (1990) (dissenting opinion) (quoted in *United States v. Ron Pair Enterprises,* 498 U.S. 235, 249 (1989) (O'Connor, J., dissenting)).

The overall structure of Section 523 demonstrates a Congressional intent to exempt from discharge "debts . . . for money . . ." where the money was "obtained by . . . fraud." As the court below held, a debt for money obtained by fraud may and frequently does exceed the precise amount the debtor received. *In re Cohen,* 106 F.3d at 57. (App. 10a). Section 523 deals with the non-dischargeability of "debts". Under New Jersey law, the *debt* petitioner incurred as a result of the money he obtained by fraud was three times the amount of the rental

overpayment. The consequence of petitioner's fraud is that the "debt", *i.e.* his liability under the New Jersey statute, is exempt from discharge.

In Part B of his argument, petitioner contends that his proposed construction of Section 523(a)(2)(A) is the only logical method to harmonize all of the exceptions to discharge. In particular he argues that, if Section (a)(2) exempts from discharge punitive damages awarded for all types of fraud, Section (a)(4) will be rendered superfluous. This argument fails for two reasons.

First, the pre-1978 Bankruptcy Act contained exemptions from discharge in substantially similar format to the present Bankruptcy Code. 11 U.S.C. § 35, 52 Stat. 840, 851 (1938, Repealed). The Bankruptcy Act contained both a general exemption for fraud, Section 17(2), and an exemption for fraud by a person acting in a fiduciary capacity, Section 17(4). When it enacted the 1978 Bankruptcy Code, Congress simply incorporated the Bankruptcy Act's exemptions from discharge into Section 523. There is simply no evidence to support the argument that in 1984 Congress decided to create less of a penalty for fraudulent debtors who were not acting in a fiduciary capacity, or that Congress intended to treat fraud by fiduciaries as particularly egregious.

Second, the premise of petitioner's argument is that the only difference between Sections (a)(2) and (a)(4) is that Section (a)(4) involves fraud in a fiduciary capacity. This premise is false. Section (a)(2) exempts from discharge "debts . . . for money . . . obtained by false pretenses, a false representation or actual fraud . . ." In contrast, Section (a)(4) exempts from discharge "debts . . . for fraud or defalcation while acting in a fiduciary capacity . . ." Thus, fraud under (a)(2) involves the "obtaining" of money, property, services or credit, while fraud under (a)(4) does not contain this requirement.

By providing for this distinction, Congress most likely recognized that fraud by a fiduciary does not always result in the fiduciary actually obtaining something. For instance, a trustee who invested a principal's money in a highly speculative business owned by the trustee's brother might well be guilty of fraud even though the trustee himself did not actually obtain anything. It seems likely that Congress would nevertheless wish to impose non-dischargeable liability for such conduct.

As the above example demonstrates, Section 523 can and should logically be interpreted as a listing of all the types of conduct which will not be subject to discharge in Bankruptcy.

B. The Construction Of The Code By The Courts Below Comports With The Legislative Purpose Of The Act.

As the Court remarked, "We do not read these statutory words with the ease of a computer". *Bank of Marin v. England*, 385 U.S. 99, 103 (1966). Resolution of this case therefore requires overriding consideration of the "equitable principles that govern the exercise of bankruptcy jurisdiction." *Id.* As it observed in *Kelly v. Robinson*, this Court looks "to the provisions of the whole law, and to its object and policy". 479 U.S. 36, 43 (1986).

In *Grogan v. Garner*, this Court reinstated a judgment holding a debt for both compensatory and punitive damages exempt from discharge under Section 523(a)(2)(A). 498 U.S. 279 (1991). It explained the policy considerations underlying Section 523 as follows:

> The statutory provisions governing non-dischargeability reflect a congressional decision to exclude from the general policy of discharge certain categories of debts-such as child support, alimony, and certain unpaid educational loans and taxes, as well as *liabilities for fraud*. Congress evidently concluded that the creditors' interest in recovering *full payment* of debts in these categories outweighed the debtors' interest in a complete fresh start. We think it is unlikely that Congress, in fashioning the standard of proof that governs the applicability of these provision, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud.

498 U.S. at 287 (emphasis added).

Under this analysis, Congress would conclude that respondents' interest in recovering "full payment of debts" outweighs petitioner's interest in a fresh start. *Id.* The full debt respondents are owed includes the treble damages which New Jersey has seen fit to award to defrauded consumers.

Petitioner is not the "honest but unfortunate debtor" entitled to a fresh start. *Grogan*, 498 U.S. at 286-87. He has not demonstrated that his construction of the statute in any way furthers this policy. He argues that the purpose of the Code is to provide a fresh start to debtors but conveniently omits that this policy is limited to "honest" debtors.

To allow petitioner to prevail would thwart Congress' intent that the Bankruptcy Court not become an arena for pardoning debtor fraud. New Jersey, like many other states, has sought to deter fraud by imposing treble damages on persons engaging in such conduct. These treble damage provisions represent a State's judgment as to the proper method of deterring such quasi-criminal behavior, and in this respect are similar to criminal restitution obligations. *See* "Punitive Damages — The Dischargeability Debate Continues", 11 Bankr. Dev. J. 707, 739-

46 (1995) (comparing punitive damages to Criminal Restitution Obligations). Given this similarity, the statement of policy in *Kelly v. Robinson*, applies equally well here:

> This Court has recognized that the States' interest in administering their criminal justice system free from federal interference is one of the most powerful of the considerations that should influence a court considering equable types of relief. See *Younger v. Harris*, supra, 401 U.S. at 44-45, 91 S. Ct., at 750-751. This reflection of our federalism also must influence our interpretation of the Bankruptcy Code in this case.

479 U.S. at 49.

This Court has not limited the *Younger* principle to criminal cases, but has extended it to those areas where the state has a substantial interest. *See Middlesex County Ethics Committee v. Garden State Bar Ass'n*, 457 U.S. 423 (1982). Surely, deterring fraud against its citizens is such a state interest.

The treble damages provided for here represent a policy decision by the State. *See Pacific Mutual Life Ins. Co. v. Haslip*, 499 U.S. 1, 19 (1991). This Court should not lightly infer that Congress intended to interfere with that policy. As the court aptly noted in *In re Manley*:

> Precisely because punitive damages are noncompensatory and quasi-criminal in nature, courts should treat them with respect; for to interfere with the enforcement of such punitive damages is to interfere with the State's own (indirect) attempts to discipline unruly citizens and to deter outrageous misbehavior. A Bankruptcy Court which categorically discharges such punitive damages declares, in effect, that equity will come to the rescue of those who clearly intend evil; and that the U.S. Congress intends its bankruptcy courts to act against the benefit of society, to free transgressors from restraint, and to encourage future wrongdoing!

135 B.R. 137, 147 (Bankruptcy N.D. Okl. 1992).

To accept petitioner's argument would require him to return to the respondents only that portion of his debt which represents the precise amount he fraudulently overcharged them. It would provide no deterrent for such conduct whatsoever. This not only nullifies the State's judgment on the proper method to deter such fraud, but countenances the Bankruptcy Code as a shield for the dishonest debtor. Such a result surely cannot have been within the contemplation of Congress when it enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984.

C. The Legislative History Of The Bankruptcy Amendments Act Does Not Support The Construction Placed On This Section By The Petitioner.

The legislative history of the 1984 Act is consistent with the Third Circuit's construction of the statute. In their analysis of this history, respondents do not seek to alter the plain meaning of the Act itself, but to demonstrate that nothing in the history supports the petitioner's claim that the amendments altered pre-1984 bankruptcy practice.

Two factors should inform this Court's consideration of the legislative history of the 1984 Act. First, contrary to petitioner's assertion, it is clear that prior to 1984 punitive damages awarded for fraud were exempt from discharge under Section 523(a)(2)(A). The Bankruptcy Act itself, prior to its revision in

1978, exempted from discharge "liabilities for obtaining money or property by false pretenses or false representations." Pub. L. 91-467, § 17(a)(2), 84 Stat. 990, 992 (1970). Given the broad definition of liabilities utilized by the Code, there is no cogent argument that punitive damages awarded as a result of the debtor's fraudulent conduct were treated differently than compensatory damages.

No case directly presenting the issue of dischargeability of punitive damages under the pre-1978 Act has been decided by this Court.[8] However, lower courts consistently held that non-dischargeability under Section 523(a)(2)(A) or its predecessor was "an 'all or nothing' proposition." *Birmingham Trust Nat. Bank v. Case*, 755 F.2d 1474, 1477 (11th Cir. 1985). There, the Court held that differences between § 523(a)(2)(A) and its predecessor, § 17(a)(2) of the Bankruptcy Act, are negligible, and therefore case law construing § 17(a)(2) serves as a useful guide in applying § 523(a)(2)(A).

Under Section 17a of the Bankruptcy Act, the entire debt awarded for fraud was considered non-dischargeable. This was noted in *Brown v. Felsen*:

> Section 17a, the focus of this case, provides that certain *types* of debts are not affected by a discharge. These include, under § 17a(2), "liabilities for obtaining money or property by false pretenses or false representations . . . or for willful and malicious conversion of the property of another" and, under § 17a(4), debts that "were created by his fraud, embezzlement, misappropriation, or defalcation

8. Although petitioner ascribes the reason for this dearth of case law on the rarity of punitive damage awards, the more likely explanation is that, prior to 1970, dischargeability issues were normally resolved by state courts. *See Brown v. Felson*, 442 U.S. 127, 129 (1979).

> while acting as an officer or in any fiduciary capacity."

442 U.S. 127, 129 (emphasis in original). By focusing on "types" of debts and "liabilities" for fraud, the Court was clearly indicating that all sums awarded against a debtor based on fraudulent conduct were non-dischargeable.

The second factor informing this Court's view of the legislative history is the principle of statutory construction that, if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. *Midlantic Nat. Bank v. New Jersey Dep't. of Environmental Protection*, 474 U.S. 494, 501 (1985). While respondents agree that this principle will not overcome specific language in a statute, the present language of Section 523(a)(2)(A) is simply not the model of clarity that petitioner suggests. The sheer number of lower court decisions on both sides of this issue attest to the lack of any such clarity in the language of this statute. (*See* Petition for Certiorari, p. 10-13). Thus, resorting to the legislative history of the 1984 Act is appropriate. *Toibb v. Radloff*, 501 U.S. 157, 162 (1991).

Apparently because of the time constraints imposed by *Northern Pipeline*, *supra*, contemporaneous legislative materials are scant.[9] There is no Senate or House report. 1984 U.S. Code Cong. and Adm. News 576. The history is limited to statements by individual legislative leaders and to an analysis of the Act. Nowhere do the Congressional statements or the analysis discuss the amendment to Section 523.

9. Congressman Rodino, chairman of the House Judiciary Committee, observed that the resulting Act was introduced "to the surprise, amazement and relief of many". 130 Cong. Rec. H. 20225 (June 29, 1984).

In addition to satisfying the dictates of *Northern Pipeline*, Congress was concerned with two substantive issues: the effect of corporate reorganizations on labor contracts as the result of the *Bildisco* decision[10], and the plight of farmers upon the bankruptcy of grain elevator operators. *See* Statements by Senator Dole, 130 Cong. Rec. S. 20083 (June 29, 1984) and Senator Hatch, 130 Cong. Rec. S. 20085 (June 29, 1984).

What little discussion took place regarding the balance of the 1984 Act evidenced not a concern for the plight of fraudulent debtors, but rather efforts to stem bankruptcy abuse. For instance, Senator Dole remarked that "this bill provides important new protections for good faith creditors seeking recovery upon their claims in consumer debtor cases." 130 Cong. Rec. S. at 20083. Senator Hatch noted the dramatic rise in consumer bankruptcy cases and observed that the Act "contains over 30 substantive amendments to curb abuses of the bankruptcy code". 130 Cong. Rec. S. 20088. Senator Biden remarked that the legislation "eliminates provisions of that act [the 1978 revisions to the Bankruptcy Code] which have been unduly burdensome for good faith creditors seeking to recover on legitimate claims". 130 Cong. Rec. S. 13071 (May 21, 1984).

Against this backdrop of concern with bankruptcy abuse by debtors and the proliferation of bankruptcy petitions, it is difficult to imagine that Congress, *without any debate whatsoever*, elected to relieve fraudulent debtors of the full consequences of their fraud. Such an assumption would require this Court to conclude that Congress, in the face of repeated statements expressing concern over debtor abuse, suddenly and without explanation decided to carve out an exception to Section 523 which benefitted not all debtors, but only fraudulent ones.[11]

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10. *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513 (1984).

11. Petitioner's argument that the attorney's fee provision contained (Cont'd)

The absence of any discussion by Congress on the amendment to Section 523 supports the Tenth Circuit's observation that "there is no reason to conclude that the 1984 amendments were anything but technical and cosmetic." *In re Gerlach*, 897 F.2d 1048, 1051 n.2 (1990). Petitioner's argument that his reading of the 1984 Act comports with Congress' fresh start policy overlooks the correlative policy expressed in the above legislative statements. The Code "also seeks to protect creditors whom the debtor has harmed by egregious conduct." *In re Britton*, 950 F.2d 602, 606 (9th Cir. 1991); *In re St. Laurent*, 991 F.2d 672, 680 (11th Cir. 1993).

This legislative history supports the Court of Appeals' holding that the amendment to Section 523(a)(2)(A) was intended only to modify "refinancing of credit" and to distinguish between "fraudulently and legally refinanced credit." *In re Cohen*, 106 F.3d at 57. (App. 10a). This construction is buttressed by two additional factors.

First, as explained in *In re Danns*, 558 F.2d 114 (2nd Cir. 1977), lower courts were in conflict on the meaning of Section 17(a)(2) of the Bankruptcy Act as it related to refinancing of credit. The issue arose when a debtor obtained a loan legitimately

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(Cont'd)
in Section 523(d), assessing fees against creditors who lose dischargeability claims, demonstrates a Congressional intent to protect individuals against abusive creditors. This argument is misplaced. First, Section 523(d) was not part of the 1984 Act. *See Sullivan v. Finbelstein*, 496 U.S. 617, 631 (1990) (Scalia, J. concurring). Second, such fees are available to debtors who prevail in discharge cases — not debtors such as petitioner who have been found to have committed fraud.

Moreover, as petitioner concedes, Congress in 1978 considered but rejected a proposal to eliminate the dischargeability exemption provided by Section 523(a)(2)(B). (*See* Brief for Petitioner at p. 30). This rejection hardly demonstrates concern for the plight of fraudulent debtors.

but subsequently secured additional sums through a fraudulent refinancing. Courts questioned whether the entire loan was exempt from discharge, but the court in *Danns* held that only the amount obtained by the fraudulent refinancing was nondischargeable. It may well be that the 1984 amendment to Section 523 was intended to codify the holding in *Danns*.

The decision below is also buttressed by the form in which Congress chose to amend the Code. Section 454(a)(1)(B) of Pub. L. 98-353 (the 1984 Act) amended Section 523(a) by:

> striking out "refinance of credit" and inserting in lieu thereof "refinancing of credit to the extent obtained."

98 Stat. at 375. This method by which Section 523(a) was amended supports the Court of Appeals' analysis that the purpose of the amendment was related to the refinance of credit. *In re Cohen*, 106 F.3d at 57. (App. 10a).

Because there is no indication that Congress sought to depart from past bankruptcy practice, this Court should not infer that the 1984 amendment to Section 523(a)(2)(A) was intended to provide for the discharge of punitive damages awarded as a consequence of the debtor's fraud.

D. The Third Circuit's Interpretation Of Section 523(a)(2)(A) Is Congruous With The Policy Underlying Bankruptcy Law — A Fresh Start For Honest Debtors.

The decision below is consistent with the intentions of the bankruptcy laws. 106 F.3d 52 (3rd Cir. 1997). "... [W]e conclude that punitive damages are not nondischargeable under 11 U.S.C. § 523(1)(2)(A)." *Id.* at 59. (App. 14a). "Discharge is a means to achieve the legitimate purpose of providing *honest debtors* with a *deserved* 'fresh start.' " *In re Manley*, 135 B.R. 137, 147 (Bkrtcy. N.D. Okla. 1992). The bankruptcy code does

not and should not provide a place for the fraudulent debtor to escape his wrongdoing.

Bankruptcy is a means of providing a "fresh start" to honest debtors. However, "guaranteeing a fresh start does not imply a head start." Remarks of Senator Hatch, 130 Cong. Rec. S. at 20088. In *Grogan v. Garner*, this Court considered it implausible that "Congress ... would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud". 498 U.S. 279, 287. If the Third Circuit's holding is not affirmed, dishonest debtors will regard bankruptcy as a way to escape full liability for fraud, which directly contradicts the purpose behind the Code.

Before this Court, petitioner does not challenge the trial court's finding of fraud. Instead, petitioner argues that, if the Third Circuit's holding is upheld, it would result "in the nondischargeability of windfall amounts payable to major commercial creditors, at the expense of the opportunity for individual debtor's to escape" insolvency. (Brief for Petitioner, p. 29). Petitioner's argument is misplaced. If fraud has been committed by a debtor, the creditor, whatever its size, should have the right to collect the entire judgment awarded. In petitioner's own situation, had he not committed fraud, no punitive damages ever would have been assessed against him.

Petitioner argues that imposing punitive damages on already destitute individuals contravenes the policy that punitive damages should not financially ruin the defendant. (Brief for Petitioner, p. 27 n.16). This argument is likewise misplaced. The damages awarded here are limited to three times the respondents' "ascertainable loss of money" N.J. Stat. Ann. § 56:8-19.[12] *See*

12. N.J. Stat. Ann. § 56:8-19 provides:

Any person who suffers any ascertainable loss of moneys

(Cont'd)

Garcia v. General Motors Corp., 910 F. Supp. 160 (D.N.J. 1995). Therefore, the damages imposed are not only limited by statute but "the debtor is fully aware at the time of his commission of the fraud of the full amount of the 'debt' he will owe on a determination that he has committed such fraud". *Cohen,* 106 F.3d at 59 (App. 14a).

Therefore, in order to maintain the "central purpose of the Code", the Third Circuit's holding should be affirmed. *Grogan v. Garner*, 498 U.S. at 286.

(Cont'd)

or property, real or personal, as a result of the use of employment by another person or any method, act, or practice declared unlawful under this act or the act hereby amended and supplemented may bring an action or assert a counterclaim therefore in any court of competent jurisdiction. In any action under this section the court shall, in addition to any other appropriate legal or equitable relief, award threefold the damages sustained by any person in interest. In all actions under this section the court shall also award reasonable attorneys' fees, filing fees and reasonable costs of suit.

CONCLUSION

For all of the reasons set forth above, the judgment of the United States Court of Appeals for the Third Circuit must be affirmed.

Respectfully submitted,

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